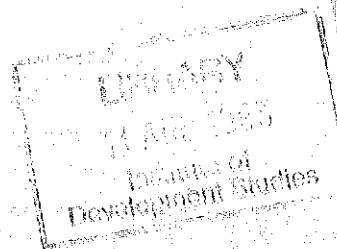


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THE NIGERIAN BANKING SYSTEM IN THE CONTEXT OF POLICIES OF FINANCIAL REGULATION AND DEREGULATION:



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AFRICAN ECONOMIC RESEARCH CONSORTIUM
CONSORTIUM POUR LA RECHERCHE ECONOMIQUE EN AFRIQUE

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of policies of financial regulation and
deregulation**

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**The Nigerian banking system
in the context of policies of financial
regulation and deregulation**

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I Introduction

Many developing countries are currently undergoing structural adjustment programmes (SAPs) in which liberalization of the various sectors of the economy is a major policy thrust. Accordingly, the free-market system is being assigned an increasing role in the allocation of resources. Of the various sectors that have been regulated, the financial sector is perhaps the most important given its role as the lubricant of the engine of growth that drives the economy.

In Nigeria, financial repression, characterized by the policies of directed credit and an interest rate ceiling, is believed to have caused some imperfections in the operations of the financial market. McKinnon (1988) asserted that financial repression policies such as usury restrictions on interest rates, heavy reserve requirements on bank deposits, and compulsory credit allocations, interact with ongoing price inflation to reduce the attractiveness of holding claims on the domestic banking system. In addition, broad money supply falls as a proportion of GNP. In particular, McKinnon (1973) and Shaw (1973) postulated that the fragmentation of the capital market resulting from financial repression also has adverse consequences for the quality and quantity of capital formation. Such consequences include:

- a reduction in the flow of loanable funds through the organized banking system, forcing potential investors to rely more on self-finance;
- an arbitrary variation in interest rates on the truncated flow of bank lending between classes of favoured and dis-favoured borrowers;
- the impairment of the process of self-finance within enterprises and households, primarily because if the real yield on deposits is negative, firms cannot easily accumulate liquid assets in preparation for making discrete investments, thus making socially costly inflation hedges more attractive as a means of internal finance;

- significant financial deepening outside the repressed banking system becoming impossible when firms are dangerously illiquid and/or inflation is high and unstable (McKinnon, 1988).

Financial liberalization has been recommended as a policy to overcome the problems of financial repression, although the experience of the Southern cone countries of Argentina, Chile and Uruguay in this regard has not been encouraging. In spite of this experience, with the advent of SAP, Nigeria adopted the policy of financial deregulation, starting with the introduction of the second-tier foreign exchange market (SFEM) in 1986 and culminating in the policy of deregulation of interest rates in 1987. This study is an attempt to evaluate this policy *ex post*. It aims at using simple descriptive indices to assess the impact of policies of financial regulation and deregulation on the financial system over time, and in particular on savings mobilization.

In the second section of this paper we discuss the changes that the Nigerian banking system has experienced since its inception with a view to placing the different financial policies of the government in proper focus. A review of macro policies and environment with a view to highlighting their conditioning influence on policies of financial regulation and deregulation is given in Section III. Section IV reviews regulatory practices in the Nigerian banking system and classifies the different banking regulation periods in Nigeria using credit-control practices as criteria, while Section V evaluates the performance of the Nigerian banking system *vis à vis* the regulatory periods identified in Section IV and the overview presented in Section III. Section VI presents the conclusion and recommendations.

II The changing face of the Nigerian banking system

Inanga and Soyibo (1989) characterized the changes undergone by the Nigerian banking system since 1894, when the African Banking Corporation was formed, as consisting of four phases:

1. the era of relatively stable banking environment (1894-1952);
2. the first banking boom era (1952-59);
3. the era of regulation (1959-86); and
4. the era of deregulation (1986 to date).

During the first phase, banking business was monopolized by foreign banks, namely the African Banking Corporation, which was the precursor of the former Standard Bank and the present First Bank of Nigeria; the Colonial Bank which predated the former Barclays Bank and the present-day Union Bank; and the British and French Bank, the forerunner of the present United Bank of Africa. Alleged discrimination against Nigerians by these banks led to the founding of indigenous banks which offered little or no competition to the foreign banks, essentially because of their weak capital base and low managerial capacity. Consequently, all but three of them failed.

The second phase began with the enactment of the Nigerian Banking Ordinance in 1952 which introduced some regulation into banking. The state of the economy between 1952 and 1958, and the minimal regulation of the industry by the 1952 Ordinance, gave further impetus to the establishment of more indigenous banks, all of which failed, during this period. Hence, the period is described as the "era of the first banking boom". The bank failures of this era were attributed, amongst other things, to the monopolistic nature of the foreign banks which enjoyed exclusive patronage from British firms.

The period 1959-86, the era of banking regulation, began with the enactment of the Central Bank of Nigeria Act of 1959 which gave legal backing to the establishment of the Central Bank of Nigeria (CBN). This Act empowered the CBN to promote and integrate the Nigerian financial system. Thus, the CBN was able to enact effective regulatory measures to stem the tide

of bank failures that followed the first banking boom. The Act also gave substantial incentive to the development of the money and capital markets of the country.

In this new and encouraging climate, more commercial banks sprang up in the country. Thus, between 1959 and 1960, eight new commercial banks were established, bringing the total number to 12, and this increased to 17 by 1962 (Teriba, 1970). Under the 1968 Companies Act, foreign-based banks operating in Nigeria were obliged to be incorporated in the country. Also during this period government implemented the following regulatory measures:

- acquisition of controlling shares first in the "big three" commercial banks, namely, First Bank, Union Bank and the United Bank of Africa;
- the use of the policy of directed credit;
- the use of strict control of interest rates; and
- substantial increase in the paid-up capital of new banks.

The fourth phase of banking development in Nigeria, the era of deregulation, resulting in the second banking boom, came as a result of SAP in which the government assigned an increasing role to the market in the allocation of resources. It started with the introduction of the second-tier foreign exchange market (SFEM) which later became the foreign exchange market (FEM), and most recently the inter-bank foreign exchange market (IFEM). The peak of this period was probably reached with the deregulation of interest rates when the CBN ceased to prescribe interest rates chargeable on loans and advances or payable on deposits. This period has been characterized by an increasing number of new commercial and merchant banks. Between 1986 and 1 May 1989, a total of 38 new commercial and merchant banks opened their doors, while 25 others were granted licences to start operation before the end of that year (Inanga and Soyibo, 1989).

In particular, between 1988 and 1989, the number of commercial banks increased from 40 to 47 (17.5 per cent), while the number of commercial bank branches/offices increased from 1,655 to 1,844, representing an increase of 10.8 per cent (Table 1). The growth in number of merchant banks has been the most spectacular. Table 1 shows that the number of merchant banks increased nearly 42 per cent from 24 in 1988 to 34 in 1989. At the end of 1989, the total number of commercial banks and merchant banks in Nigeria was 81. Currently (1990), the number of banks is well over 105 with over 20 licensed to begin operations at any time (Nwadike, 1990).

The period of deregulation has witnessed strategic changes in banking operations in Nigeria. Among these changes are the creation of the Nigeria Deposit Insurance Corporation (NDIC) by Decree No. 22 of 15 June 1988

(though the Corporation did not take off effectively until March 1989.) The NDIC is charged with the responsibility of insuring bank deposits, ensuring safe banking practices through effective supervision, and assisting the CBN to formulate banking policies with a view to ensuring the stability of the financial system (NDIC, 1989). Given the fears being expressed by Nigerians about the proliferation of banks, derisively called "eaglet banks", and the possibility of bank failures, the success of the NDIC has probably instilled some confidence in the Nigerian banking system. All commercial and merchant banks are required by Section 20 of Decree 22 of 1988 to insure their deposits with NDIC. Depositors are assured of immediate cash payments up to a maximum of 50,000 naira in case of any bank failure (NDIC, 1989).

Table 1 Growth in banks and bank branches (1988/89)

End of year	Commercial		Merchant		Total no. of branches/offices
	No. of banks	No. of offices	No. of banks	No. of offices	
1988	40	1,655	24	46	1,711
1989	47	1,844	34	60	1,904
% growth	17.5	10.8	41.7	30.4	11.3

Source: Nigerian Deposit Insurance Corporation, Annual Report and Statement of Accounts, 1989.

Another change witnessed by the banking system during the era of deregulation involved the increase in minimum paid-up capital. Effective from September 1989, minimum paid-up capital for commercial banks increased from 10 million naira to 20 million naira while for commercial banks it became 12 million naira (increased from 6 million naira).

The establishment in 1989 of the People's Bank of Nigeria by the Federal Government has changed the concept and practice of banking in Nigeria. This bank aims at increasing the access of low-income groups such as artisans, craftsmen, mechanics, petty traders, etc., to bank credit. The traditional concepts of granting credit, such as collateral, are not employed. Rather, group pressure and cohesiveness via co-operatives are the means employed. However,

the credit granted to the individual is small, varying between 50 and 2,000 naira. Initial reports at end of the first year of operation suggest that the beneficiaries are aware of their loan-repayment obligations.

The introduction of the community banks, as announced in the 1990 Federal Government Budget Speech, is perhaps the most novel and radical of all the financial policies introduced by the government since the period of deregulation. CBIC (1990) defined a community bank as a self-sustaining financial institution, owned and maintained by a community or a group of communities, for the purpose of providing credit, banking and financial services to its members, largely on their self-recognition and credit-worthiness. This is in contrast to the near total reliance of orthodox banks on viable and negotiable collateral as the basis for giving credit.

Community banks perform most of the services of orthodox banks, such as acceptance of deposits, issuance of redeemable debentures, and receipt of money or collection of proceeds of banking instruments on behalf of customers. However, they are required *not* to engage in sophisticated banking services like foreign exchange transactions and international commercial papers, corporate finance, etc., in order to enable them to retain their local focus (CBIC, 1990). A community bank must raise a minimum equity share capital of 250,000 naira before it can be licensed and no individual is allowed to own more than 5 per cent of the shares. The community bank operates under the concept of unit banking, quite different from the concept of branch banking operated by older banks, including most merchant banks, and lately, the People's Bank.

The People's Bank and community banks, it is believed, will be an easier means of mobilizing rural savings and giving credit to the rural populace. Orthodox banks have failed through the rural banking programme to make their presence felt in rural areas, often alleging that branches established in rural areas are loss centres. The introduction of the concept of community banking and People's Bank is expected to fill this critical gap in the Nigerian banking system.

III Overview of macroeconomic policies in Nigeria

The financial system is affected by the larger macroeconomic framework in which it operates, for good or for ill. In this section, we provide an overview of the general macroeconomic policies of Nigeria with a view to placing in proper perspective the likely impact of the economic environment on the banking system *vis à vis* the policies of financial regulation and deregulation. The review will concentrate on the macro-policies of the 1980s since the decade spans both the eras of financial repression and liberalization in Nigeria.

In general, the economic policies of the 1980s in Nigeria were designed to achieve two major objectives:

- the acceleration of the rate of domestic production by expanding the productive capacity of the non-oil sector, in particular, agriculture and manufacturing;
- a reduction in the rate of inflation and the attainment of a healthy balance-of-payments position in terms of an acceptable level of external reserves.

What distinguished this decade is the different policy measures and methodologies adopted to achieve the objectives.

Monetary policy

At the beginning of the decade, monetary policy was expansionary. For example, between 1981 and 1983, the aggregate credit expansion ceiling for commercial and merchant banks was as high as 25-35 per cent. The monetary measures of that period were ostensibly designed to provide an optimum level of bank credit and to channel such credit to more productive and small-scale enterprise sectors of the economy as a means of raising the level of employment and output of goods and services. The policy of directed credit in

1981 required that 56 per cent of banks' credit portfolios be set aside for the production sub-sector of the preferred sectors. These sub-sectors consist of agricultural production, mining, manufacturing, agro-allied industries, and construction. The services sub-sector was expected to have a 12 per cent share of total credit.

The minimum liquidity ratio for the period 1981-83 was 25 per cent, while cash ratio was 5 per cent for banks with a minimum 300 million naira deposit and 2 per cent for other banks. The rediscount rate in 1981 was 6 per cent, while the lending rate for agricultural production by the Nigerian Agricultural and Co-operative Bank (NACB) was also 6 per cent. However, in 1982, there was an upward revision in interest rate, with the maximum lending rate becoming 12 per cent. As part of the austerity measures introduced in April 1982 to stem the excessive drain on the nation's foreign reserves, interest rates were raised by two percentage points across the board, but then revised downward again by one percentage point in November of the same year. In 1983, the maximum lending rate became 13 per cent, while the minimum rediscount rate was 7 per cent. Agricultural lending by the NACB attracted 6-7 per cent interest.

From 1984, monetary policy began to be restrictive. The objectives were to clear the backlog of accumulated trade debt and achieve substantial improvement in the balance-of-payments position, to stimulate domestic production, especially of food and raw materials, and to reduce the rate of inflation. The credit expansion limit for commercial and merchant banks was reduced from 25 per cent to 12.5 per cent in 1984, and in 1985 it was further reduced to 7 per cent. This became 8 per cent in the first quarter of 1987, only to be reduced to 7.4 per cent for the last three quarters of the year. With improvements in the economy, the credit expansion limit for banks was raised to 12.5 per cent in 1988. However, in 1989, aggregate credit expansion was limited to 9.5 per cent.

The interest-rate ceiling policy continued until 1 August 1987 when interest rates were deregulated, while the liquidity ratio remained at 25 per cent until 1987 when it became 30 per cent at the inception of the policy of financial liberalization. This was reduced to 27.5 per cent in 1988.

Restrictive monetary policy in Nigeria during the 1980s became accentuated with the introduction of the second-tier foreign exchange market (SFEM), primarily to moderate inflationary pressures likely to accompany its introduction. Thus, in 1987, for example, the following credit policy targets were set by monetary policy:

- 11.8 per cent growth in money supply (M_1);
- 4.4 per cent growth in aggregate bank credit;

- 8.4 per cent growth in credit to the private sector;
- rediscount rate raised from 11 to 15 per cent effective from 1 August 1987.

Upward revision of interest rates to encourage mobilization of resources and promote a more efficient allocation of available loanable funds characterized the period 1984-87 which pre-dated the deregulation of interest rates. Thus, in 1984, interest rates generally were raised by 1.5-2 percentage points, except that the maximum lending rate and the lending rate for agriculture still remained at 13 and 7 percentage points, respectively. However, in 1985, interest charged for lending to agricultural production by commercial banks was raised to 9 per cent, while that of the NACB was raised from 6-7 per cent to 8-9 per cent.

Fiscal and commercial policies

The major objectives of the fiscal and commercial policies of the Federal Government of Nigeria in the 1980s were:

- moderation of inflationary pressures;
- promotion of equitable distribution of income;
- promotion of the use of local raw materials;
- reduction in the level of imports with a view to relieving the heavy pressures on the nation's external reserves as well as stabilizing the exchange rate of the naira; and
- generation of increased government revenue, particularly from non-oil sources.

The first half of the decade was characterized by strict controls, as exemplified by the use of the policy of import restriction and use of import licences. At the beginning of the decade there were some restrictions on imports, and import licences were required to import some commodities while others were placed on open general licence. However, as an anti-inflationary measure, in 1981 the government stopped the issuance of licences to individuals for the importation of rice. By 1983, when the economy had gone deeper into recession, a total of 152 commodities were added to the list of imports requiring import licences. In particular, individual raw materials and intermediate goods, which hitherto were largely on open general licence, were also brought under specific import licence to enhance control over foreign exchange expenditure.

The policy of protecting local industries underlies the import duty policy of government during the decade under review. For example, in 1982, import duty on tyres was raised from 55 kobo to 65 kobo per kilogramme, while a 5 per cent duty was imposed on bolts and nuts, which hitherto had been duty-free. Many more items had their import duties revised upward in 1983, an example being the import duty on starch which was increased from 33.3 per cent to 100 per cent with a view to stimulating production. The approved users scheme and the general concessionary rates of duty, which granted low and concessionary rates on raw materials and other intermediate products imported by designated manufacturers producing import-substitutes, were abolished in 1984. In addition, an *ad valorem* tax ranging from 10 to 75 per cent was levied on raw materials and intermediate products which hitherto attracted low rates. These policy instruments were aimed at encouraging local sourcing of raw materials.

A comprehensive tariff structure, designed to last for seven years, was adopted in 1988 and was expected to provide a higher degree of protection for local industries and reduction in the number of excisable products. In 1989, to protect local industries further, import duties on a number of intermediate products used in local industries were reduced; an example was battery parts where import duty was reduced from 45 to 20 per cent.

In the 1980s, taxation policy was aimed at raising greater revenue for the government. Thus, in 1981, there was an amendment to the Companies Income Tax Law which empowered the Federal Board of Inland Revenue to impose a maximum tax of 2 per cent based on turnover or 45 per cent of taxable profit, whichever is higher. Also, the Income Tax Management Act of 1961 and the Companies Income Tax Act of 1979 were amended by the Finance (Miscellaneous Taxation Provision) Decree of 1985. Under the amendment, the rate of tax deductible at source in respect of rents, dividends and interest rose from 12.5 to 15 per cent. The maximum capital allowance for manufacturing companies was set at 75 per cent of assessable income, while the straight-line method of depreciation was adopted in calculating capital allowance for the purpose of tax relief.

Another objective of taxation policy during the period was the promotion of investment with a view to reflation of the economy. Among the instruments used to pursue the achievement of this objective were the following policies adopted since 1988:

- exemption from taxation of all investment incomes earned outside Nigeria;
- adoption of a lower company tax rate of 20 per cent for 3 years for small and medium-sized companies with annual turnover of 500,000 naira and

- below engaged either in manufacturing, agricultural production or mining of solid minerals; and
- the adoption of a 15 per cent *maximum* tax for all investment incomes.

In general, commercial policy in the 1980s aimed at protecting infant domestic industries and encouraging food production. To achieve the latter, guaranteed minimum prices for major staple food crops were increased in 1981. The early years of the decade witnessed relaxation of foreign exchange controls, with an individual basic travel allowance which was well over \$1,000 before the recession. Foreign exchange controls were introduced in 1982 at the beginning of the recession. The introduction of SFEM in 1986 decontrolled foreign exchange allocation leaving the determination of its value to market forces. Two major methods have been adopted in determining the value of the naira in terms of other major currencies such as the dollar, the pound sterling and the deutschmark. These were the marginal rate method and the Dutch auction method. A major consequence of both methods is the massive depreciation of the naira which in April 1991 stood at about 8.80 to the dollar. However, it appears that the naira depreciates more with the Dutch auction method. Government, through the intervention of the CBN, had adopted several methods of mopping up liquidity in the banking system to strengthen the naira. One such method is the use of stabilization securities.

IV A review of the regulatory practices in Nigerian banking

The CBN, on behalf of the Federal Government of Nigeria, issues annual credit policy guidelines to banks and other financial institutions like insurance companies. Up to 1990, 24 such policy circulars had been issued. Each monetary policy circular, as the credit guidelines are often called, begins with a review of the performance of the economy for the preceding year with a view to putting the new government policy guidelines in focus in relation to the objectives and targets being proposed.

The guidelines then provide the aggregate credit ceilings for the fiscal year in question for commercial and merchant banks, prescribe the sectoral distribution of loans and advances by banks and spell out the structure of merchant and/or commercial bank assets. The circular also contains policy information relating to loans to indigenous borrowers and rural areas, capital funds of banks, as well as reserve requirements. The interest-rate policy to be pursued during the year, deadlines and milestones on the rendition of mandatory monetary and financial statistics by banks to the CBN, as well as penalties prescribed for default, are also contained in the monetary policy circular.

One way in which these regulatory practices can be classified relates to the degree of disaggregation of sectoral credit allocation. We posit that the greater the level of disaggregation of sectoral distribution of credit, the higher the degree of control and regulation. This is because banking operators tend to have less freedom and flexibility of operation in such situations.

Accordingly, we classify the practice of banking regulation in Nigeria into four periods, thus:

- the era of strict control lasting up to 1983 and coinciding with the period when there were up to 18 sector/sub-sector categories of credit allocation;
- the era of less strict control (in contrast to *moderate* control) between 1984 and 1985 when the sectoral/sub-sectoral categorization of credit was compressed to eight;

- the period of moderate control, consisting only of the year 1986, when the sectoral categorization was compressed to four and this coincided with the beginning of the era of financial liberalization; and
- the era of relaxed control/deregulation from 1987 to the present when the two-sector categorization of credit was introduced.

Table 2 summarizes the sectoral categorizations of credit allocation during these periods, based on the scheme described above.

In 1985, Monetary Policy Circular No. 19 directed that the merchant banks' portfolio of financial assets should be structured as follows:

- a minimum of 50 per cent of total loans and advances shall be medium-term in nature with maturity of not less than three years;
- a maximum of 20 per cent of loans and advances shall be short-term in nature, i.e. maturing within 12 months; and
- a maximum of 15 per cent of total assets shall be in equipment leasing.

The year 1985 also marked the introduction of grace periods varying from one year (for seasonal cash crops like cotton and groundnuts) to seven years (for ranching) in agricultural lending. Also, effective from January 1985, new banking application and licence fees of 2,500 naira and 10,000 naira respectively, were fixed. These measures were still in effect in 1990. In effect, more measures aimed at effecting and ensuring soundness of the financial system were put in place from the period of less strict control.

Complementary measures that ensure flexibility of operations on the part of the banking industry began to be put in place from the eras of moderate and relaxed control. For example, while interest rates were not deregulated in 1986, in spite of the introduction of the SFEM, from October 1987 the interest-rate policy was made more flexible with the credit guidelines specifying the rediscount rate and the maximum lending rate. In 1987, greater flexibility of operation was granted to merchant banks with the ratio of loans and advances to total assets being raised from 50 to 55 per cent.

By 1988, in another forward-looking policy decision, the CNB's credit policy guideline provided a new definition of the small-scale enterprise as one whose turnover is not more than 500,000 naira (when dealing with commercial banks) and whose limit of investment is 2 million naira (excluding cost of land), or which has a maximum turnover of 5 million naira (when dealing with a merchant bank). In 1988 banks were granted permission to own equity in

Table 2 Regulatory credit control practices in Nigeria using sectoral categorization of directed credit

(i) Period of strict control lasting until 1983: 18 sector/sub- sector categorization	(ii) Period of less strict control 1984-85: 8 sector/sub- sector categorization	(iii) Period of moderate control 1986; 4 sector/ sub-sector categorization	(iv) Period of relaxed control/ deregulation from 1987; 2 sector categorization
A. Preferred sectors*	A. Preferred sectors*	A. Preferred sectors*	A. High priority sectors*
(i) Production 1. Agriculture 2. Mining 3. Manufacturing 4. Construction (a) Residential (b) Others	1. Agriculture (Agriculture, forestry and fishing) 2. Industrial enterprises a. Manufacturing (including agro-allied industries) b. Others (mining and quarrying, other industries)	(i) Agriculture (grain produc- tion and distribution; livestock; others) (ii) Industrial enterprises (manuf- acturing, residential building and construction) (iii) Services (exports, public utilities)	(a) Agricultural production (b) Manufacturing enterprises
(ii) Services 1. Public utilities 2. Transportation	3. Residential building and construction		
(iii) Exports	4. Exports		
(iv) Development finance institutions	5. Services (public utilities, transport and communication)		

Table 2 cont ...

(i) Period of strict control lasting until 1983: 18 sector/sub- sector categorization	(ii) Period of less strict control 1984-85: 8 sector/sub- sector categorization	(iii) Period of moderate control 1986; 4 sector/ sub-sector categorization	(iv) Period of relaxed control/ deregulation from 1987; 2 sector categorization
B. Less preferred sectors	B. Less preferred sectors	B. Less preferred sectors	B. Other sectors
(v) General commerce 1. Exports 2. Imports 3. Domestic trade 4. Bill discounted	6. General commerce (Imports, domestic trade) 7. Government 8. Others (credit and financial institutions, personal and professional services)	(Government, credit and financial institutions, personal and professional)	
(vi) Others 1. Credit and financial institutions 2. Government 3. Personal and professional 4. Miscellaneous			

*Percentage shares of directed credit to preferred sectors are regarded as maxima, while those of less preferred sectors are minima.

companies. However, no bank may invest more than 10 per cent of its paid-up capital in one company and its overall ownership in various enterprises may not exceed 33.3 per cent.

It is perhaps the 1990 credit policy guidelines that have been most flexible and accommodating. For example, in order to allow new banks to grow, any such bank with total credit not exceeding 50 million naira at the end of December 1989 would be allowed to attain a credit level of 50 million naira before any ceiling on credit growth is applied. It also relaxed the restrictions on the structure of merchant banks' financial assets portfolio while granting commercial banks permission to engage in equipment leasing to the tune of 15 per cent of their total assets. However, the guidelines raised the capital adequacy ratio from 1:12 to 1:10. Besides, the guidelines requested banks with subsidiary companies to report on the operation of such companies along with their own reports. Also, merchant banks, which were hitherto excluded from the observance of cash-reserve requirements, were subjected to a cash-reserve requirement of 5 per cent of their total demand deposit liability. Thus, the era of financial liberalization seems to be installing universal banking practices in Nigeria.

V Performance analysis

Savings mobilization

Among the arguments advanced in favour of financial liberalization is the fact that strict regulation of the financial markets, particularly the policies of directed credits and sectoral prescription of interest-rate ceilings, often promotes present consumption and acts as a disincentive to saving. In this section we provide a descriptive analysis of the extent of mobilization of savings by the formal Nigerian financial system during the period under study with a view to identifying possible trends in the reactions of Nigerian savers to change in government monetary policy.

Tables 3 and 4 give an analysis of institutional savings between 1970 and 1989, while Tables 5 and 6 show the same information in real terms. Figure 1 provides visual representation of the data. The tables show that commercial banks dominate the market for institutional savings in Nigeria. In the 1970s, they mobilized between 80 and 89 per cent of total institutional deposits. However, in the 1980s, this pre-eminent position, though still maintained, began to be eroded by merchant banks which controlled between 10 and 27 per cent of the market share of institutional savings between 1985 and 1988. In the early 1970s, the merchant banks' share was only slightly above 1 per cent; thus this nearly ten-fold improvement in the mobilization of savings between 1985 and 1986 is commendable. This may not be unconnected with the increasing number of merchant banks that have come on the scene with the advent of financial liberalization (Table 1).

Both tables show that banks predominate in the mobilization of deposits in the Nigerian financial market, controlling over 90 per cent of the market. Of all the other financial intermediaries, the National Provident Fund is the one that seems to have some applicable impact, although, by the 1980s it had begun to trail behind merchant banks.

In order to assess the effects of the policies of financial repression and liberalization on deposit mobilization, the data of Tables 5 and 6, which are in real terms, were utilized. A comparison of the growth rates in Tables 3 and 4, on the one hand, and Tables 5 and 6 on the other, shows marked

Table 3 Analysis of cumulative institutional savings in Nigeria (1970-79)

Year	Commercial banks: time and savings	National Provident Fund	Federal Savings Bank	Federal Mortgage Bank	Merchant Bank time deposits	Premium bond savings cert. and savings stamp	Total	Annual growth rate (%)
1970	336.7 (80.24)	67.4 (16.06)	4.9 (1.17)	2.6 (0.61)	7.6 (1.88)	0.1 (n)	419.6 (100.0)	
1971	371.8 (80.09)	76.6 (16.50)	4.5 (0.94)	4.0 (6.86)	7.2 (1.55)	0.1 (n)	464.2 (100.0)	9.9
1972	456.9 (80.65)	89.2 (15.75)	4.3 (0.75)	5.3 (0.94)	10.8 (1.91)	0.1 (n)	566.5 (100.0)	22.0
1973	582.3 (80.97)	109.7 (15.25)	4.5 (0.63)	5.5 (0.77)	17.1 (2.38)	0.1 (n)	719.2 (100.00)	27.0
1974	973.2 (85.59)	129.8 (11.42)	4.7 (0.41)	7.3 (0.64)	22.3 (1.94)	0.1 (n)	1,137.1 (100.0)	58.1
1975	1,572.3 (86.60)	159.9 (8.81)	8.1 (0.45)	11.8 (0.65)	63.4 (3.49)	0.1 (n)	1,815.6 (100.0)	59.7
1976	1,979.1 (87.75)	193.9 (8.60)	6.9 (0.31)	16.3 (0.72)	58.9 (2.62)	0.1 (n)	2,255.2 (100.0)	24.2

(cont ...)

Table 3 cont ...

Year	Commercial banks: time and savings	National Provident Fund	Federal Savings Bank	Federal Mortgage Bank	Merchant Bank time deposits	Premium bond savings cert. and savings stamp	Total	Annual growth rate (%)
1977	2,255.1 (87.44)	230.4 (8.90)	8.0 (0.26)	11.9 (0.64)	82.4 (3.68)	0.1 (n)	2,587.9 (100.0)	14.8
1978	2,601.7 (86.44)	269.9 (9.97)	8.1 (0.26)	19.2 (0.64)	110.7 (3.68)	0.1 (n)	3,009.7 (100.0)	16.3
1979	3,702.1 (89.06)	305.1 (7.33)	8.5 (0.20)	23.7 (0.57)	117.3 (2.82)	0.1 (n)	3,156.8 (100.0)	38.1

Notes: Numbers in parentheses are percentages; n = negligible; values are as at end of December, million naira, at current prices.

Table 4 Analysis of cumulative institutional savings in Nigeria (1980-89)

Year	Commercial banks: time and savings deposits	National Provident Fund	Federal Savings Bank	Federal Mortgage Bank	Merchant Bank time deposits	Premium bond savings cert. and savings stamp	Total	Annual growth rate (%)
1980	5,163.2 (89.49)	338.9 (5.87)	7.3 (0.71)	40.7 (0.71)	219.7 (3.81)	0.1 (n)	5,769.9 (100.0)	38.8
1981	6,023.5 (88.78)	370.1 (5.46)	5.3 (0.08)	57.2 (0.84)	328.0 (4.83)	0.1 (n)	6,784.2 (100.0)	17.6
1982	6,838.2 (85.32)	411.5 (5.4)	4.0 (0.05)	69.3 (0.86)	691.3 (8.63)	0.1 (n)	8,014.9 (100.0)	18.1
1983	8,082.9 (85.46)	472.8 (4.59)	5.0 (0.05)	89.9 (0.95)	793.7 (8.40)	0.1 (n)	9,443.9 (100.0)	11.8
1984	9,391.3 (85.46)	504.7 (4.59)	8.0 (0.07)	114.0 (1.04)	970.6 (8.83)	0.1 (n)	10,988.7 (100.0)	16.4
1985	10,550.9 (84.19)	540.5 (4.3)	8.1 (0.07)	114.9 (0.99)	1,318.2 (10.52)	0.1 (n)	12,532.7 (100.0)	14.1

(cont ...)

Table 4 cont ...

Year	Commercial banks: time and savings deposits	National Provident Fund	Federal Savings Bank	Federal Mortgage Bank	Merchant Bank time deposits	Premium bond savings cert. and savings stamp	Total	Annual growth rate (%)
1986	11,487.7 (82.35)	579.6 (4.16)	17.0 (0.12)	125.6 (0.90)	1,739.7 (12.47)	0.1 (n)	13,949.7 (100.0)	11.3
1987	15,068.7 (80.69)	593.5 (3.18)	20.2 (0.11)	148.6 (0.80)	2,822.8 (15.12)	0.1 (n)	18,673.9 (100.0)	33.9
1988	18,397.1 (79.34)	605.0 (2.61)	22.4 (0.10)	180.4 (0.78)	3,982.8 (17.18)	0.1 (n)	23,187.8 (100.0)	24.2
1989	16,976.9 (84.05)	679.1 (3.36)	37.5 (0.19)	n.a.	2,505.2 (12.40)	0.1 (n)	20,198.8 (100.0)	-12.9

Source: computed from Central Bank of Nigeria: *Annual Report and Statement of Accounts* (various issues)

Notes: Numbers in parentheses are percentages; n = negligible; n.a. = not available; * provisional; values are as at end of December, million naira, at current prices.

Table 5 Analysis of cumulative institutional savings in Nigeria (1973-80)

Year	Commercial banks: time and savings deposits	National Provident Fund	Federal Savings Bank	Federal Mortgage Bank	Merchant Bank time deposits	Premium bond savings cert. and savings stamp	Total	Annual growth rate (%)
1973	1,289.4 (80.97)	242.9 (15.25)	10.0 (0.63)	12.2 (0.77)	37.9 (2.38)	0.22 (n)	1,592.6 (100.0)	-
1974	1,452.2 (85.59)	193.7 (11.42)	7.0 (0.41)	10.9 (0.64)	33.3 (1.94)	0.15 (n)	1,697.3 (100.0)	6.6
1975	1,989.5 (86.60)	202.3 (8.81)	10.2 (0.45)	14.9 (0.65)	80.22 (3.49)	0.13 (n)	2,297.3 (100.0)	35.4
1976	2,174.8 (87.74)	213.1 (8.60)	7.6 (0.31)	17.9 (0.72)	64.7 (2.62)	0.11 (n)	2,478.21 (100.0)	7.9
1977	2,255.1 (87.44)	230.4 (8.90)	8.0 (0.26)	11.9 (0.64)	82.4 (3.68)	0.1 (n)	2,587.9 (100.0)	4.4
1978	2,336.9 (86.44)	242.4 (9.97)	7.3 (0.26)	17.3 (0.64)	99.5 (3.68)	0.09 (n)	2,703.5 (100.0)	4.5
1979	2,982.4 (89.06)	245.7 (7.33)	6.9 (0.20)	19.1 (0.57)	94.5 (2.82)	0.08 (n)	3,348.7 (100.0)	23.9
1980	3,838.2 (89.49)	251.9 (5.87)	5.4 (0.71)	30.3 (0.71)	163.3 (3.81)	0.07 (n)	4,289.17 (100.0)	28.1

Notes: Numbers in parentheses are percentages; n = negligible; values are in real terms at 1977 prices (million naira)

Table 6 Analysis of cumulative institutional savings in Nigeria (1981-90)

Year	Commercial banks: time and savings deposits	National Provident Fund	Federal Savings Bank	Federal Mortgage Bank	Merchant Bank time deposits	Premium bond savings cert. and savings stamp	Total	Annual growth rate (%)
1981	8,282.0 (88.78)	508.9 (5.46)	7.3 (0.08)	78.6 (0.84)	451.0 (4.83)	0.13 (n)	9,327.9 (100.0)	-
1982	8,840.6 (85.32)	432.0 (5.4)	5.2 (0.05)	89.6 (0.86)	893.7 (8.63)	0.13 (n)	10,361.23 (100.0)	11.1
1983	9,583.7 (85.46)	580.6 (4.59)	5.9 (0.05)	106.6 (0.95)	941.1 (8.46)	0.12 (n)	11,198.02 (100.0)	8.1
1984	9,391.3 (85.46)	504.7 (4.59)	8.0 (0.07)	114.0 (1.04)	970.6 (8.83)	0.1 (n)	10,998.7 (100.0)	-1.9
1985	10,106.2 (84.19)	517.7 (4.3)	7.8 (0.07)	110.1 (0.99)	1,262.6 (10.52)	0.09 (n)	12,004.5 (100.0)	9.2
1986	11,222.8 (82.35)	566.2 (4.16)	16.6 (0.12)	122.7 (0.90)	1,699.5 (12.47)	0.09 (n)	13,627.9 (100.0)	13.5
1987	10,804.3 (80.69)	425.5 (3.18)	14.5 (0.11)	106.5 (0.80)	2,023.9 (15.12)	0.07 (n)	13,374.8 (100.0)	-1.9
1988	10,028.4 (79.34)	329.8 (2.61)	12.2 (0.10)	98.3 (0.78)	2,171.1 (17.18)	0.06 (n)	12,639.9 (100.0)	5.5
1989	5,927.1 (84.05)	237.1 (3.36)	13.1 (0.19)	n.a. n.a.	874.6 (12.40)	0.04 (n)	7,051.9 (100.0)	-44.2
1990	7,029.15 (82.5)	246.1 (2.9)	*	93.7 (1.1)	1,151.4 (13.5)	0.04 (n)	8,520.74 (100.0)	20.8

Notes: Figures in parentheses are percentages; n = negligible; n.a. = not available; * = transformed to a commercial bank. Values are in real terms at 1984 prices (million naira).

differences. It is easily seen that the growth rates in deposit mobilization are exaggerated at constant prices. From the tables it can be seen that the real growth rates of deposit mobilization varied between 4.5 and 7.9 per cent in 1975, 1979 and 1980. The real growth rate of 35.4 per cent experienced in 1975 may have been due to the sudden oil wealth that came in the wake of the Arab-Israeli War and the sudden increase in oil prices. In the same way, the high growth rates in 1979 and 1980 may have been due to the expansionary monetary policy of the civilian administration.

By discounting the effect of expansionary monetary policy, it appears that, using the real growth rate, the type of financial system control regime has some effect on deposit mobilization by the banking system. This is easily brought to focus by using the real annual growth rate figures of Table 6. In this table, it is seen that the real annual growth rate in the latter part of the era of strict control is less in general than that of the period of less strict control and that of the era of relaxed control/deregulation except for the real negative growth rate in 1989.

Figure 1 Composition of institutional savings in Nigeria (1972-88)

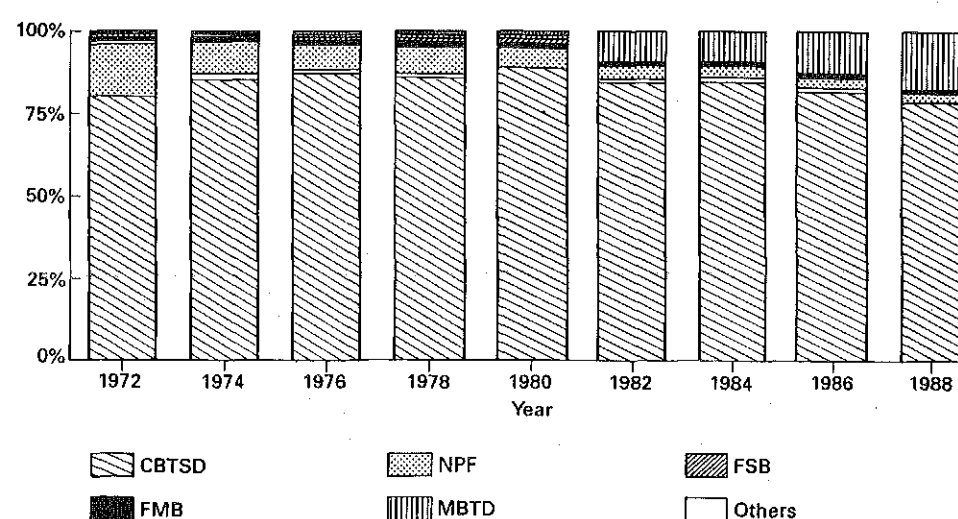


Table 7 Some indices of financial intermediation in Nigeria (at current prices)

Year	Total institutional deposits (naira m)	GDP* at current factor cost (naira m)	Money supply M ₂ ** (naira m)	Ratio of institutional deposit to GDP	Ratio of institutional deposit to M ₂	Ratio of M ₂ to GDP
1970	419.6	5,621.00	956.9	0.08	0.44	0.17
1971	464.2	7,098.00	1,005.3	0.07	0.46	0.14
1972	566.5	7,703.00	1,161.4	0.07	0.49	0.15
1973	719.2	10,991.00	1,414.0	0.07	0.51	0.13
1974	1,137.1	18,811.00	2,156.2	0.06	0.53	0.11
1975	1,815.6	21,779.00	3,624.6	0.08	0.50	0.17
1976	2,255.2	27,572.00	5,467.9	0.08	0.41	0.20
1977	2,587.9	32,520.00	6,310.5	0.08	0.41	0.19
1978	3,009.7	35,540.00	7,395.6	0.09	0.41	0.21
1979	4,156.8	36,593.30	9,848.7	0.11	0.42	0.27
1980	5,769.9	41,479.80	14,397.4	0.14	0.40	0.35
1981	6,784.2	50,456.63	15,548.1	0.14	0.44	0.31
1982	8,014.4	51,570.32	16,894.0	0.16	0.47	0.33
1983	9,443.9	56,709.77	19,368.9	0.17	0.49	0.34
1984	10,988.7	63,066.19	21,600.5	0.17	0.51	0.34
1985	12,532.7	71,368.10	23,818.6	0.18	0.53	0.33
1986	13,949.7	72,128.24	24,592.7	0.19	0.57	0.34
1987	18,673.9	106,883.20	29,994.6	0.18	0.62	0.28
1988	23,187.8	142,678.26	38,449.9	0.16	0.60	0.27

Sources:

* For 1970-79, *International Financial Statistics Year Book*(1970-1985) and *Federal Office of Statistics, Lagos*, years 1979-88.** CBN, *Economic and Financial Review* and Nigeria's Principal Economic and Financial Indicators

Table 7 provides some descriptive indices of financial intermediation in Nigeria between 1970 and 1988. Between 1970 and 1979, the ratio of institutional deposits to GDP varied between 0.06 and 0.11 with an average of 0.08 (Table 8). In the 1980s, the ratio increased to about 0.19 (1986) and declined to 0.18 and 0.16 in 1987 and 1988, respectively. This ratio can be interpreted as the proportion of the national output that is put away as savings. Thus, in general, it can be seen that Nigerians have rather poor banking habits.

From Table 8 it can be seen that the proportion of national output that is saved in Nigeria does not appear related to the type of regulation imposed on the financial system. This is because the average proportion of the GDP that is saved institutionally varied between 0.08 and 0.18 during the era of strict regulation, increasing marginally to 0.19 during the period of moderate control, only to decline to 0.17 during the period of relaxed control/deregulation. However, the impact of restrictive monetary policy during the period of relaxed control/deregulation, as mentioned earlier, may be responsible for this observation. Thus, conflict of policies is one area that needs to be addressed formally by Nigerian policy makers if the intended results are to be effectively and efficiently achieved.

What can also be deduced from Table 7 is that Nigeria showed little improvement in saving part of the national product since the 1970s. Indeed, when this result is compared with that of Bhatia and Khatkhate (1975), Nigeria has not shown much improvement over its performance in the 1960s either. Besides, Nigeria lagged behind other African countries like Côte d'Ivoire, Kenya, Malawi and Zambia over the period 1960-70. There is, therefore, a need for Nigerians to improve their savings habits in order to generate investible funds internally in line with the policy of self-reliance.

From Table 7, the ratio of institutional deposits to broad money supply, M_2 , can be seen to vary between 40 per cent and 62 per cent. This ratio can be interpreted as the proportion of broad money in circulation that is saved in the formal system. In general, Nigerians can be said to save, on the average, about 50 per cent of M_2 . This also indicates poor saving habits.

Another index that can be used to assess the impact of financial intermediation is the ratio of M_2 to GDP. McKinnon (1988) describes this ratio as measuring *bank loanable funds*.

The ratio can be interpreted as the proportion of the national product that is available as currency in circulation, consisting of part of the pool that will be available to banks to give out as loans. Thus, this ratio can be used as a possible proxy for measuring the link between money supply and investment. However, the ratio between institutional deposits and money supply can measure this link more directly through savings-mobilization efforts, particularly of the banking system.

The table shows that in the 1970s the value of the ratio for Nigeria varied between 0.11 and 0.27, with an average of 0.17 (Table 8). This performance is below that of the four Latin American and the four Asian countries studied by McKinnon (1988) whose averages were, respectively, 0.18 and 0.25 for the period 1960-80. However, the ratio improved to about 0.34 over the period 1984-86, and declined to 0.28, on average, during the period 1987-88 (Table 8). Nigeria's performance during the 1980s compares favourably with that of Korea whose values were 0.32-0.33 between 1970 and 1980. However, Nigeria lagged considerably behind Japan (between 0.86 and 1.39), Germany (between 0.58 and 0.91), Taiwan (between 0.46 and 0.75) and Singapore (between 0.70 and 0.83), during the period 1970-80 (McKinnon, 1988).

From Table 8, it can also be deduced that the variation in the ratio of M_2 to GDP does not seem related to any policy of regulation or deregulation of the banking system. However, the variation in the average real growth rate of institutional savings suggests some link, even if weak, between the different regulatory regimes of the financial system and the deposit mobilized. Thus, there is a tendency for the average real growth rate to rise with more relaxed control. The observed negative growth rate during the era of relaxed control/deregulation can be attributed mainly to the very high negative growth rate of 1989 which may be due more to inflation than anything else. A formal modelling method was used in another study (Soyibo and Adekanye, 1990) to confirm this claim.

Increase in the number of banks

There is no denying the fact that financial liberalization has brought about a sudden increase in the number of banks operating in Nigeria. Table 9 shows that 43 banks were established in Nigeria between 1986 and 1989. We recall that 1986 was the beginning of the period of financial liberalization — the year we described as the period of moderate control. Of these 43 banks, 42 were established during the era of relaxed control/liberalization. More than half (54 per cent) were merchant banks. Thus, there is likely to be keener competition in the industry, resulting in the designing of new products.

Nwadike (1990) reported the existence of 151 different banking products in Nigeria in 1990, though analysis showed that most of these instruments need more creativity and ingenuity. However, the fact that the Nigerian banks are now challenged to create different products is an indication of increasing competition, which will lead to an improvement in bank service delivery. The era of "arm chair" banking is gone. People also fear possible bank failures as a result of the increasing application of aggressive banking practices. From

Table 8 Some descriptive performance measures of regulation and deregulation in Nigeria

	Strict control period (1970-79) (1980-83)		Less strict control period (1984-85)	Moderate control period (1986)	Relaxed control/ deregulation period (from 1987)
Average institutional deposit (million naira current prices)	1,713.8	7,503.1	10,216.3	13,949.7	20,930.9
Average ratio of institutional deposit to GDP	0.08	0.15	0.18	0.19	0.17
Average ratio of institutional deposit to M_2	0.46	0.45	0.52	0.57	0.61
Average ratio of M_2 to GDP	0.17	0.33	0.34	0.34	0.28
Average annual real growth rate of institutional deposits (%)	13.8*	9.6**	3.7	13.5	-5.0

Notes: *1974-79 **1982-83; 1973-79 growth rates are based on 1977 prices while the others are based on 1984 prices.

Table 9 Number of new banks in Nigeria (1986-89)

	1986	1987	1988	1989	Total
Commercial banks	1	5	7	7	20
Merchant banks	-	4	9	10	23
Total	1	9	16	17	43

Source: Inanga and Soyibo (1989) for 1986-88 values; NDIC (1989) for 1989 values

Table 3, we see a 12.9 per cent decline in the growth of total institutional savings between 1988 and 1989. NDIC (1989) attributed this to increased competition for deposits by banks and an interest-rate "war". In a moderating tone, the 1990 CBN Credit Policy Guidelines stipulated the maximum spread between the savings rate and the prime lending rate for each bank. This is put at 7.5 percentage points. Similarly, the margin between the prime rate and the highest lending rate was put at a maximum of 4 percentage points, while the inter-bank interest rate was put at least 1 percentage point below the prime rate for each lending bank.

VI Conclusion and recommendations

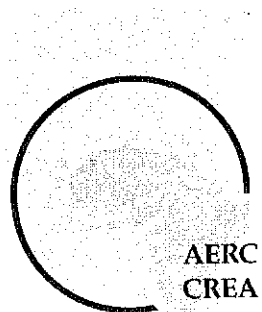
The balance sheet on the policies of financial regulation and deregulation in Nigeria, as discussed in this paper, suggests that there is more in favour of the policy of financial deregulation than against it. The policy of financial liberalization has changed the face of the Nigerian banking system. There is an increase in the number of banks, promoting competition in the industry. Furthermore, banking, as it was traditionally known in Nigeria, has changed with the introduction of the People's Bank and Community Banks. Besides changes in the practice of banking, the adoption of the *unit banking* concept underlying community banking is a novelty in Nigeria. Before the inception of community banks, branch banking was the vogue. The dividing line between merchant and commercial banking is becoming thinner and thinner with financial liberalization as some functions which used to be the exclusive preserve of merchant banks (e.g. equipment leasing) are now performed by commercial banks. Thus, financial liberalization is introducing the concept of *universal banking* into Nigeria.

We have shown in this paper that there is some evidence, however weak, that there is a positive relationship between savings mobilization and financial liberalization in Nigeria, as we argued that the apparent decline in some indices of financial liberalization during the era of relaxed control/deregulation is due mainly to conflict of policies rather than the policy of liberalization *per se*. Accordingly, it is suggested that policy makers should endeavour to avoid conflicting policies so as to minimize their undesired effects.

This study has also shown that Nigerians appear to have poor banking habits when compared with other Africans. It is, therefore, suggested that deliberate policies promoting deposit mobilization among Nigerians, even if mandatory, be put in place. Nigerians cannot claim to be poorer than other Africans who put away a higher proportion of their national product against a rainy day. The desire to pursue the self-reliant strategy that is entailed in SAP demands personal sacrifice. This will probably be rewarding to the economy as the banking sector is likely to be particularly good in allocation of the domestic credit so mobilized to the most socially productive uses.

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